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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1808

GENERAL INSURANCE COMPANY OF AMERICA,
Petitioner,

VERSUS

OKLAHOMA CITY HOUSING AUTHORITY, ET AL.,
Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Petitioner, General Insurance Company of America ("General"), submits this Reply Brief pursuant to Supreme Court Rule 24(4) in response to the Brief in Opposition to Petition for Certiorari ("Brief in Opposition") filed by respondent, Oklahoma City Housing Authority ("OCHA"). The abbreviations used in the Petition will be used in this Reply Brief.

ARGUMENT

I.

THE SUPREME COURT MUST RESOLVE THE CONFLICTS AMONG THE COURTS OF APPEALS CONCERNING THE JURISDICTION OF FEDERAL BANKRUPTCY COURTS IN CHAPTER XI PROCEEDINGS.

As shown in General's Petition (pp. 14-18), the Courts of Appeals are squarely in conflict on the issue raised by this application: whether a bankruptcy court (in this case, in Colorado) has exclusive jurisdiction to determine the debtor's (here the contractor, Globe's) claims to unpaid contract balances, including retainage, in the possession of a third party (here the contracting owner, OCHA).

In the instant case, both the Oklahoma District Court and the Colorado Bankruptcy Court purported to exercise jurisdiction over contract balances in OCHA's possession but claimed by Globe, General's principal. The Oklahoma District Court awarded the funds to OCHA; the Colorado Bankruptcy Court awarded the funds to Globe. The resolution of the inconsistent judgments rendered by the Oklahoma and Colorado District Courts depends upon the resolution of the conflict among the Courts of Appeals as to the extent of the exclusive jurisdiction granted federal bankruptcy courts in Chapter XI proceedings. The Supreme Court should grant a writ of certiorari to settle this important question of federal bankruptcy law.

In its Brief in Opposition, OCHA failed to respond to the most important issue presented by General's Petition. OCHA appears to accept that a conflict among the

Courts of Appeals exists on the extent of the exclusive jurisdiction granted bankruptcy courts, but seeks to avoid the application of the conflict to the instant case. The erroneous and superficial arguments raised by OCHA require only brief discussion.

1. Conflicting District Court Judgments.

At pages 5-6 of the Brief in Opposition OCHA merely outlines its version of the three judgments entered as between OCHA and Globe and the one judgment entered as between OCHA and General. Because only one of the four judgments was entered directly against General, OCHA concludes that no conflicting district court judgments exist.

OCHA's position is unsupportable. One judgment, founded solely upon the vicarious liability of a surety, may not be isolated and considered without regard to the transactions from which it arose or from the liability of the principal for whom the surety must answer. If Globe is not liable to OCHA, then no liability can be attached to General, which has only derivative liability as surety under Globe's performance bond (Petition, at 22-23, and authorities cited therein). The judgment of the Oklahoma District Court against General under the performance bond necessarily had to be predicated upon a finding of Globe's liability for breach of contract. Directly contrary to the Oklahoma District Court's finding that Globe was liable under its contract with OCHA, the Colorado Bankruptcy Court found that Globe was *not* so liable.

When considering OCHA's Proof of Claim filed in Globe's Chapter XI proceedings, the Colorado Bankruptcy

Court properly held the judgment underlying the Proof of Claim void because the Oklahoma District Court had been divested of jurisdiction to determine liability of Globe to OCHA when the bankruptcy proceeding was commenced. The Colorado Bankruptcy Court then considered the merits of the claims underlying the void judgment; and because Globe had filed an objection setting forth offsets, the Bankruptcy Court also considered the merits of Globe's counter-claims against OCHA. An evidentiary hearing was conducted after due notice to OCHA which provided ample opportunity to be heard. *OCHA chose not to appear.* After the hearing, the Colorado Bankruptcy Court found that Globe's offsets from the contract balances exceeded OCHA's claims and held that Globe was not liable to OCHA (Petition Appendix, at A-35, A-39). *OCHA did not appeal.*

The Colorado Bankruptcy Court's judgment disallowing (as opposed to discharging) OCHA's claim constituted a complete exoneration of Globe, and therefore an exoneration of Globe's surety, General, as well. As indicated in General's Petition herein, the disallowance of a claim by a bankruptcy court is an adjudication upon the merits of the debt underlying the claim. *Katchen v. Landy*, 382 U.S. 323 (1966) (Petition, at 23). The authorities are unanimous that the disallowance of a claim against the bankrupt-principal (Globe) collaterally estops the creditor (OCHA) from pursuing the disallowed claim against the surety (General). 1B J. MOORE FEDERAL PRACTICE, ¶ 0.419[3.-5] (1978); J. MACLACHLIN HANDBOOK OF THE LAW OF BANKRUPTCY 139 (1956); A. STEARNS, THE LAW OF SURETYSHP § 6.43.

The judgments of the two district courts are totally inconsistent as to General. One supports a finding of the surety's liability; the other mandates a finding of no liability. The conflict is clear and absolute; the question is which should control. General has demonstrated in its Petition that although there is a conflict among the Courts of Appeals, the better reasoned view is that the jurisdiction of the Colorado District Court under the Bankruptcy Act was exclusive, and that the judgment of that Court should prevail.

2. Determination of Globe's Liability by the Oklahoma District Court.

OCHA asserts that the Oklahoma District Court determined only the liability of General under the performance bond and not Globe's liability (Brief in Opposition at 1). OCHA's statement is totally inaccurate. The determination of Globe's liability was a necessary precondition for the imposition of liability by the Oklahoma District Court on General, as Globe's surety (Petition, at 22).

The judgment rendered against General by the Oklahoma District Court contains numerous paragraphs of "findings" that Globe breached the contract with OCHA and that Globe committed fraud against OCHA (Petition Appendix, at A-9, A-15 to A-20). Despite its bland assertion at the beginning of its Brief in Opposition that "In the proceedings which are the subject of this Petition, the liability of the bankrupt was not determined" (Brief in Opposition, at 1), throughout the later pages of the same Brief, OCHA unhesitatingly reiterates the purported find-

ings of Globe's alleged wrongdoing by the Oklahoma District Court as "reasons" to uphold the judgment against General (Brief in Opposition, at 3, 4, 8-10, 14-16).

OCHA's attempt to avoid the jurisdictional conflict between the Oklahoma and Colorado District Courts on the basis that the liability of Globe to OCHA was not determined by the Oklahoma District Court is unsupported in fact and law.

3. Jurisdiction of the Bankruptcy Court in Chapter XI Proceedings.

At pages 7-10 of its Brief in Opposition, OCHA attempts to avoid the jurisdictional dispute involving the Chapter XI proceedings by asserting that there were no contract balances against which Globe could make a claim, and hence over which the Bankruptcy Court could exercise jurisdiction. OCHA does not, however, deny that \$195,000.00 was withheld as retainage from the payments to Globe for work completed; nor does OCHA deny that it submitted a claim in the Colorado District Court, and thus submitted itself to the jurisdiction of the Bankruptcy Court. OCHA further fails to deny the extent of the Colorado District Court's jurisdiction under the Bankruptcy Act.

OCHA's contention that it was not required to pay the contract balances to Globe is founded upon the Oklahoma District Court proceedings *subsequent to October 3, 1974, the date that exclusive jurisdiction over Globe's estate vested in the Colorado Bankruptcy Court.*

It has been and remains General's position that after October 3, 1974, the Oklahoma District Court had no jurisdiction to make any determination concerning Globe's estate, including any determination of Globe's rights to contract balances. Both the spirit and the language of the Bankruptcy Act plainly require that those matters be decided and administered solely in the bankruptcy proceedings.

Subsequent to the filing of Globe's bankruptcy, the Colorado Bankruptcy Court constituted the only forum for the determination of the validity, if any, of OCHA's claimed defenses of fraud and breach of contract to OCHA's otherwise clear contractual obligation to pay the contract balances to Globe. Hence, unless certiorari is granted by this Court, General's derivative right to set off the contract balances awarded Globe in the bankruptcy proceedings against amounts otherwise owed by General to OCHA will be totally lost through the wrongful exercise of jurisdiction by the Oklahoma District Court.

OCHA's argument that no contract balances are due Globe, and therefore none are available as credits to General, simply begs the question. OCHA contends that the contract balances do not exist because the Oklahoma District Court awarded them as a forfeiture to OCHA. The argument assumes that the Oklahoma District Court had jurisdiction over the contract balances and ignores the very issue raised by this Petition that the exercise of jurisdiction by the Oklahoma District Court conflicted with the exclusive jurisdiction of the Colorado Bankruptcy Court to determine the validity of Globe's claims to the contract balances (Petition, at 19-24).

None of the arguments of OCHA refute the fact that General's liability to OCHA in the instant action depends upon whether the exclusive jurisdiction vested in the Bankruptcy Court over Globe's claims to contract balances. If the Colorado Bankruptcy Court had exclusive jurisdiction to determine Globe's rights to the contract balances, then the awarding of the contract balances to OCHA by the Oklahoma District Court is null and void. Because the contract balances exceed the liability of General to OCHA, General will be completely exonerated from liability to OCHA.

* * *

OCHA does not and cannot contest the fact that Chapter XI proceedings are the most commonly used debtor rehabilitative vehicle (Petition, at 13-14). The rapid growth of the use of Chapter XI proceedings increases the risk of inconsistent assertions of jurisdiction by different federal courts in the future.

The conflict among the Courts of Appeals over the extent of jurisdiction of bankruptcy courts over property of the debtor (REMINGTON Possession Theory vs. COLLIER Ownership Theory) is squarely presented by General's appeal (Petition, at 14-18). The exoneration of General from liability to OCHA depends upon whether the REMINGTON or COLLIER position is adopted. General's Petition provides an excellent opportunity for the Supreme Court to resolve the conflict among the circuits because resolution of the conflict is determinative of the outcome of the instant litigation.

II.

THE DECISION OF THE TENTH CIRCUIT EXTENDS THE LIABILITY OF GENERAL BEYOND THE TERMS OF THE HUD PERFORMANCE BOND CONTRARY TO APPLICABLE LAW.

In its Brief in Opposition, OCHA fails to respond to General's position that the judgment of the Oklahoma District Court, affirmed by the Tenth Circuit, impermissibly expands the liability of General beyond the terms of the HUD performance bond. The performance bond does not indemnify fraud by Globe. OCHA does not contend that it does. However, OCHA does not even consider the claim that denial to General of credit for the contract balances because of purported fraud by Globe is tantamount to requiring General to indemnify the fraud of Globe. Nor does OCHA address itself to Petitioner's contention that awarding OCHA attorney's fees against General based upon "bad faith" and "oppressive conduct" of Globe also unlawfully extends General's liability under the performance bond.

OCHA's response to General's position that the decision of the Tenth Circuit expands General's contractual liability ignores the different standards of liability applicable to General and to Globe, but instead simply states that the fraud of Globe "vitiates" its contract with OCHA (Brief in Opposition, at 10). OCHA merely cites authorities that refer to a general cause of action for fraud. The underlying assumption is that the liability of General is co-extensive with the liability of Globe. This assumption is false. The liability of General is strictly limited to the express terms of the performance bond, which does not indemnify the fraud of Globe (Petition, at 26-28).

The finding of fraud by Globe is important to OCHA for another reason. OCHA attempts to support its claim for the award of the architect's attorneys' fees against General as appropriate under the inherent equitable power of federal courts because of the "bad faith" and "oppressive conduct" of Globe. This argument again assumes that the liability of General is co-extensive with the purported fraud of Globe. OCHA again ignores the fact that the liability of General is determined by the strict terms of the performance bond which does not indemnify against the purported fraud of Globe.

The final response that OCHA makes to General's claim that its liability for fraud was impermissibly expanded is that credit for contract balances was not denied to General because of fraud by Globe but because the balances were expended in completing and correcting Globe's work (Brief in Opposition, at 7-8). This novel interpretation of the judgment below is totally unsupported by the record. The judgment recovered by OCHA was for *liquidated damages for delay*. OCHA's claims to the retainage as actual costs of completion is inconsistent with the claim to the judgment against General for liquidated damages. OCHA seeks both actual and liquidated damages—a double recovery against General.

The Supreme Court must not permit the standard HUD performance bond that is currently in use throughout the United States to be erroneously interpreted so as to increase radically the liability of construction sureties.

CONCLUSION

General relies upon its Petition to refute OCHA's response to the remaining issues raised by the Petition that are not addressed above.

General urges the Supreme Court to resolve the unsettled question of Federal Bankruptcy Law raised by the Petition in order to avoid future waste of judicial resources. In the instant case, Globe and General have attempted to avoid the potential injustice, waste and conflict involved in having different courts resolve identical issues. General and Globe were required to litigate in two forums, seek interlocutory orders and even take an interlocutory appeal, as well as a subsequent appeal on the merits. Receiving no relief through these efforts, General has here sought review of this Court to rectify the injustice of having one federal court exonerate the principal (and hence its surety) while another federal court imposes maximum liability on the principal (and its surety). The unjust result of the instant case and future risk of needless litigation may only be averted by granting General's Petition for Writ of Certiorari to resolve the disputed central issue of bankruptcy law.

General respectfully requests that the Supreme Court issue a Writ of Certiorari to review the decision of the Tenth Circuit on the extent of the jurisdiction of federal

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bankruptcy courts in Chapter XI proceedings and on the other issues raised by the Petition.

Respectfully submitted,

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